MINNESOTA DEPARTMENT OF
COMMERCE

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February 16, 2017 **PUBLIC DOCUMENT**

Daniel P. Wolf
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: **PUBLIC Comments of the Minnesota Department of Commerce, Division of Energy Resources**
Docket No. G022/S-16-931

Dear Mr. Wolf:

Attached are the **PUBLIC** Comments of the Minnesota Department of Commerce, Division of Energy Resources (Department) in the following matter:

In the Matter of the Petition of Greater Minnesota Gas, Inc. for Approval of 2017 Capital Structure and Permission to Issue Securities.

The petition was filed on November 30, 2016 by:

Kristine A. Anderson
Corporate Attorney
Greater Minnesota Gas, Inc.
202 South Main Street
P.O. Box 68
Le Sueur, MN 56058

The Department recommends **approval, with modifications**, and is available to answer any questions the Minnesota Public Utilities Commission may have.

Sincerely,

/s/ CRAIG ADDONIZIO
Financial Analyst

CD/ja
Attachment

MINNESOTA DEPARTMENT OF
COMMERCE

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

PUBLIC COMMENTS OF THE
MINNESOTA DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

DOCKET NO. G022/S-16-931

I. SUMMARY OF GREATER MINNESOTA GAS, INC.'S PROPOSAL

On November 15, 2016, Greater Minnesota Gas, Inc. (GMG or the Company) filed a petition (Petition) for approval of its 2017 capital structure and permission to issue securities. The Company is seeking:

- Approval of its proposed 2017 capital structure and total capitalization;
- Approval of its proposed contingency ranges for its equity ratio, short-term debt ratio, and total capitalization;
- Approval to issue securities provided that the Company's capital structure remains within the requested ranges; and
- Approval of its 2017 capital structure to remain valid until the Commission issues a 2018 capital structure order.

II. DETAILS OF GMG'S PROPOSAL

GMG requests approval of its estimated December 31, 2017 capital structure. Table 1 summarizes GMG's actual capital structure as of September 30, 2016, its projected capital structure on December 31, 2017, and the differences between the two.

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Table 1
GMG's Actual and Proposed
Capital Structures

	Actual September 30, 2016		Projected December 31, 2017		
	Amount	Percent	Amount	Percent	Difference
Common Equity	11,154,811	31.59%	13,047,669	32.94%	1,892,858
Preferred Shares	-	0.00%	-	0.00%	-
Short-Term Debt	1,030,800	2.92%	1,430,800	3.61%	400,000
Long-Term Debt	23,124,142	65.49%	25,130,551	63.45%	2,006,409
Total Capitalization	35,309,753	100.00%	39,609,020	100.00%	4,299,267
Contingency			1,390,980	3.51%	
Total with Contingency			41,000,000	103.51%	

Source: Petition, Attachment 3

GMG's proposed capital structure reflects:

- the net issuance of $2.0 million of long-term debt;
- an increase of $0.4 million in short-term debt; and
- GMG's projected net income for 15 months ending December 31, 2017 of $1.9 million.

Specific provisions for which the Company seeks approval include:

- a total capitalization of $39.6 million, excluding the proposed contingency;
- a total capitalization contingency of $1.4 million, or 3.51 percent;
- an equity ratio of 32.94 percent and an equity ratio range of 31.59 percent to 38.61 percent;
- the ability to issue short-term debt not to exceed 10 percent of total capitalization at any time while the 2016 capital structure is in effect;
- the flexibility to issue long-term debt provided that the Company remains within the equity and short-term debt contingency ranges and does not exceed them for more than 60 days; and
- approval of the 2017 capital structure until the Minnesota Public Utilities Commission (Commission) issues a 2018 capital structure order.

III. FILING REQUIREMENTS AND COMPLIANCE WITH PRIOR COMMISSION ORDERS

Minnesota Rules 7825.1000 – 7825.1500 and the Minnesota Public Utilities Commission's (Commission) May 12, 2009 Order in Docket No. E,G999/CI-08-1416 (the 08-1416 Order) contain the filing requirements for capital structure petitions.

The Department of Commerce's (Department) review indicates that GMG's Petition meets the requirements set forth in Minnesota Rules 7825.1000–7825.1500.

Points 1 and 3 of the Commission's Order in Docket No. E,G999/CI-08-1416 state, respectively:

> 1. In addition to the information currently provided, the utilities' annual capital structure filings shall include an exhibit providing a general projection of capital needs, projected expenditures, anticipated sources, and anticipated timing, with the understanding that such exhibit is not intended to require dollar-for-dollar on the uses identified in the exhibit or to limit issuances to project-specific financing. The exhibit need not list short-term, recurring security issuances.
>
> 3. Starting with the utilities' next annual capital structure filings, the utilities shall include a report of actual issuances and uses of the funds from the prior year. The report will be for information purposes only and need not cover short-term, recurring security issuances.

With respect to Point 1 of the Order, GMG stated in its Petition that it plans to issue securities to fund capital expenditures to maintain and reinforce existing plant and invest in new plant to support customer growth. Attachment No. 11 to GMG's Petition contains a summary of GMG's anticipated 2017 capital expenditures, including $3.2 million for customer additions and main extensions, and $0.5 million for system replacement and reinforcement, and vehicle and office equipment.

With respect to Point 3, Attachment No. 9 to GMG's Petition identifies two new loans issued during 2016, totaling $3.5 million.[1] Attachment No. 9 also identifies that GMG renewed its line of credit agreement. Attachment No. 10 to GMG's Petition summarizes GMG's sources and uses of funds during the prior year.

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[1] Attachment 9 also identifies three new loans from Ford Motor Credit, all with four-year terms, totaling $0.1 million.

Ordering Point 4 of the 08-1416 Order requires utilities to provide the following information within 20 days of each non-recurring issuance of securities:[2]

(1) the specific purposes for individual issuances;
(2) the type of issuances;
(3) the timing of issuances;
(4) the amount of issuances;
(5) issuance costs; and
(6) interest rates.

GMG met this reporting requirement in its May 5, 2016 Compliance Filing in Docket No. G022/S-15-956 (the 2016 Capital Structure Docket).

The Commission's February 2, 2016 Order in the 2016 Capital Structure Docket also imposed a number of requirements on the Company. The Commission's Order:

1. approved a total capitalization of up to $40.0 million, including GMG's expected 2016 year-end capitalization of $36.3 million, and a contingency of $3.6 million above that (Ordering Points 1 and 2)
2. approved an equity ratio contingency range of 31.00 percent to 38.61 percent (Ordering Point 3b);
3. required GMG, if its equity ratio was less than 31.59 percent on April 1, 2016 or thereafter, to inject equity or make other changes such that its equity ratio was at least 31.59 percent (Ordering Point 3c).
4. required that GMG maintain an equity ratio of at least 31.00 percent at all times (Ordering Point 3d)
5. required GMG to make monthly compliance filings on or before the 15th of each month containing a balance sheet, income statement, and cash flow statement for the first of the prior two months, demonstrating that its equity ratio is at least 31.00 percent, and required the Company to include amounts drawn on its line of credit in its short-term debt total (Ordering Point 3e);
6. approved a short-term debt contingency cap of 10 percent (i.e., GMG's short-term debt is not to exceed 10 percent of its total capitalization, including the contingency, for more than 60 days) (Ordering Point 4);
7. required GMG to file a new securities-issuance and capital structure petition by January 1, 2017.

After review, the Department concludes that GMG complied with all of these requirements.

[2] These reporting requirements are also required by Ordering Point 4 of the Commission's May 12, 2009 Order in Docket No. E,G999/CI-08-1416, *In the Matter of a Commission Inquiry into the Review and Approval of Securities Issuances and Capital Structures.*

IV. DEPARTMENT ANALYSIS

A. GMG'S PROPOSED CAPITAL STRUCTURE

Minn. Stat. §216B.49, subd. 3 states that:

> It is unlawful for any public utility organized under the laws of this state to offer or sell any security or, if organized under the laws of any other state or foreign country, to subject property in this state to an encumbrance for the purpose of securing the payment of any indebtedness unless the security issuance of the public utility is first approved by the commission, either as an individual issuance or as one of multiple possible issuances approved in the course of a periodic proceeding reviewing the utility's proposed sources and uses of capital funds. Approval by the commission must be by formal written order.

Further, Minn. Stat. §216B.49, subd. 4 states in part that:

> If the commission shall find that the proposed security issuance is reasonable and proper and in the public interest and will not be detrimental to the interests of the consumers and patrons affected thereby, the commission shall by written order grant its permission for the proposed public financing.

Based on the above statutes, the Department discusses the reasonableness of GMG's actual and projected capital structures, as well as its request that the Commission allow the issuance of various securities.

B. SUMMARY OF GMG'S CURRENT CAPITAL STRUCTURE AND RECENT FINANCIAL PERFORMANCE

Table 2
Summary of Change in GMG's Capital Structure During 2016

	Actual December 31, 2015		Actual September 30, 2016		
	Amount	Percent	Amount	Percent	Difference
Common Equity	10,486,357	30.50%	11,154,811	31.59%	668,454
Preferred Shares	-	0.00%	-	0.00%	-
Short-Term Debt	1,165,359	3.39%	-	0.00%	(1,165,359)
Long-Term Debt*	22,735,068	66.12%	24,154,942	68.41%	1,419,874
Total Capitalization	34,386,784	100.00%	35,309,753	100.00%	922,969

Sources and Notes:
2015 data from GMG's audited financial statements, provided in response to Department Information Request No. 1. GMG marked its entire response Trade Secret rather than specifically marking only the Trade Secret information within the document, and the Department has not included it as an attachment. However, the Department does not consider the data in the table above to be trade secret.
2016 data from Petition, Attachment 3.
*Includes current portion of long-term debt

Table 2 above summarizes the changes in GMG's capital structure during the first nine months of 2016.[3] GMG's net income of $0.7 million during this period caused the observed increase in equity, and the increase in long-term debt is the result of the issuances described above as well as principal payments on outstanding debt, most of which was used to pay off its short-term debt. GMG's equity ratio as of September 30, 2016, the most recent date for which full data was available at the time GMG filed its Petition, was right at the minimum allowed by the Commission's Order in the 2016 Capital Structure Docket. It has risen marginally since, and stood at 31.90 percent as of December 31, 2016.[4]

[3] The Department notes that GMG's compliance filing on February 11, 2016 in the 2016 Capital Structure Docket indicated that GMG's equity ratio as of December 31, 2015 was 31.01 percent. The equity ratio presented in Table 2 of 30.50 percent, which falls below the minimum of 31.00 percent allowed by the Commission's Order in the 2016 Capital Structure Docket, is based on GMG's audited financial statements, which were not available until well into 2016. The Department notes that it is not uncommon for there to be small differences between audited financial statements and unaudited company records like those used in the compliance filings. The Department is therefore unconcerned about the difference seen here, even though the audited financial data indicate that GMG violated the approved equity ratio contingency range.
[4] See GMG's February 14, 2017 Compliance Filing in the 2016 Capital Structure Docket.

Table 3 below summarizes selected financial metrics from GMG's actual income statements from recent years and its projected 2017 income statement.

Table 3:
Summary of GMG's Recent Financial Performance

		Actual					Projected
		2010-2012 Average	2013	2014	2015	12 Mos. Ended Sep. 30, 2016	2017
Income Statement Data							
Revenue	[1]	4,459,015	7,652,236	12,081,471	9,680,243	9,640,664	12,675,700
Cost of Sales	[2]	2,315,273	3,912,096	7,542,896	4,673,303	4,038,319	5,527,300
Gross Margin	[3] = [1] - [2]	2,143,742	3,740,140	4,538,575	5,006,940	5,602,345	7,148,400
as % of Revenue	[4] = [3] / [1]	48.1%	48.9%	37.6%	51.7%	58.1%	56.4%
Operating Expenses	[5]	1,529,773	1,958,503	2,736,228	3,517,905	4,114,716	4,643,573
as % of Gross Margin	[6] = [5] / [3]	71.4%	52.4%	60.3%	70.3%	73.4%	65.0%
Pre-Tax Operating Income	[7] = [3] - [5]	613,969	1,781,637	1,802,347	1,489,035	1,690,629	2,504,827
as % of Gross Margin	[8] = [7] / [3]	28.6%	47.6%	39.7%	29.7%	30.2%	35.0%
Income Tax Expense/(Benefit)	[9]	(158,667)	(418,000)	32,000	203,000	203,000	456,600
Net Utility Operating Income	[10] = [7] - [9]	772,636	2,199,637	1,770,347	1,286,035	1,487,629	2,048,227
as % of Gross Margin	[11] = [10] / [3]	36.0%	58.8%	39.0%	25.7%	26.6%	28.7%
Interest Expense	[12]	588,672	561,171	862,380	994,443	999,305	1,200,000
as % of Gross Margin	[13] = [12] / [3]	27.5%	15.0%	19.0%	19.9%	17.8%	16.8%
Interest Coverage Ratio	[14] = [7] / [12]	1.0	3.2	2.1	1.5	1.7	2.1
Net Income	[15] = [10] - [12]	183,964	1,638,466	907,967	291,592	488,324	848,227
as % of Gross Margin	[16] = [15] / [3]	8.6%	43.8%	20.0%	5.8%	8.7%	11.9%
Rate of Return							
Net Plant	[17]	14,133,766	23,407,931	27,038,557	32,120,798	32,120,798	33,770,487
Deferred Tax Asset	[18]	956,133	1,664,000	1,790,000	1,604,000	1,604,000	1,408,100
Approximate Rate Base	[19] = [17] + [18]	15,089,900	25,071,931	28,828,557	33,724,798	33,724,798	35,178,587
Approximate Average Rate Base	[20]	14,323,998	21,393,259	26,950,244	31,276,678	33,724,798	34,451,693
Approximate Pre-Tax Rate of Return	[21] = [7] / [20]	4.3%	8.3%	6.7%	4.8%	5.0%	7.3%
Approximate After-Tax Rate of Return	[22] = [10] / [20]	5.4%	10.3%	6.6%	4.1%	4.4%	5.9%
Average Debt	[23]	9,691,456	13,738,467	17,753,265	21,718,541	24,027,685	24,390,753
Average Debt Cost	[24] = [12] / [23]	6.07%	4.08%	4.86%	4.58%	4.16%	4.92%

Sources and Notes:
2010-2015 data from GMG's audited financial statements. GMG has marked these statements trade secret, and the Department has not included them as attachments.
2016 data and 2017 projected data from Petition, Attachment No. 6
The Department notes that the data presented here was marked trade secret by GMG. However, the Department has included this same data in public comments in several of GMG's prior capital structure dockets without objection from the Company.

As shown in the upper portion of Table 3, GMG's financial performance during 2015 and during the 12 months ended September 30, 2016 was noticeably worse than in 2013 and 2014. GMG's operating expenses as a percentage of gross margin rose significantly and its net operating income as a percentage of margin fell significantly, which resulted in much lower overall rates of return. GMG's interest coverage ratio (net utility operating income divided by interest expense) fell from 3.2 (2013) and 2.1 (2014) to 1.5 (2015) and 1.7 (2016).

C. REASONABLENESS OF GMG'S PROPOSED CAPITAL STRUCTURE

Table 4 below presents GMG's current and projected capital structures.

Table 4:
Summary of GMG's Actual and Proposed Capital Structures

	Actual August 31, 2015		Projected December 31, 2016		
	Amount	Percent	Amount	Percent	Difference
Common Equity	11,154,811	31.59%	13,047,669	32.94%	1,892,858
Preferred Shares	-	0.00%	-	0.00%	-
Short-Term Debt					
Line of Credit	-	0.00%	400,000	1.01%	400,000
Current Portion of Long-Term Debt	1,030,800	2.92%	1,030,800	2.60%	-
Total Short-Term Debt	1,030,800	2.92%	1,430,800	3.61%	400,000
Long-Term Debt	23,124,142	65.49%	25,130,551	63.45%	2,006,409
Total Capitalization	35,309,753	100.00%	39,609,020	100.00%	4,299,267
Contingency			1,390,890	3.51%	
Total with Contingency			40,999,910	103.51%	

Source: Petition, Attachment 6, Part 1

The Department notes that GMG's current and proposed equity ratios are significantly lower than the average equity ratio of risk-comparable gas utilities. In fact, GMG's current equity ratio is approximately ten percentage points lower than the lowest equity ratio of that group. The fiscal year-end 2015 average equity ratio of publicly traded gas utilities with bond ratings from BBB- to A- was 48.2 percent, and the lowest was 41.4 percent.[5] As in past capital structure dockets, the Department remains concerned about GMG's financial health, and the deterioration in GMG's financial performance during 2015 further underscores the Department's concerns. The Department notes that GMG's results for the first nine months of 2016 have been similar to 2015, and that in order to keep its equity ratio from falling below the 31.59 percent floor set by the Commission, **[TRADE SECRET DATA HAS BEEN EXCISED]**.

As shown in Table 4, GMG's proposed capital structure reflects an increase in total capitalization of $4.3 million, comprised of $1.9 million in equity and $2.4 million in total debt. The Company's need for funds is driven by its continuing, aggressive system expansion efforts. GMG's capital expenditures since 2009 are shown in Table 5 below. Approximately 85 percent of capital expenditures planned for 2017 will go towards system expansion, as has the majority of GMG's capital expenditures since 2012.

[5] See Department Attachment 1.

Table 5
GMG's Capital Expenditures

Year	Capital Expenditures
2009	558,983
2010	493,031
2011	969,911
2012	2,535,540
2013	8,304,102
2014	4,205,616
2015	6,016,773
2016	3,925,791
2017*	3,702,000

Sources and Notes:
2009-2015 data from Table 5 of the Department's Dec. 30, 2015 Comments in Docket No. G022/S-15-956
2016 data from GMG's Feb. 14, 2017 Compliance Filing in Docket No. G022/S-15-956
2017 data from Petition, Attachment 12
* Projected

With respect to its long-term capital expenditure plans GMG stated in its response to Department Information Request No. 7:

> GMG's capital budget is driven by system reliability and safety, government-sponsored and/or mandated road construction projects, and customer requests for service that meet the requirements of GMG's main extension rules. GMG has continued to steadily decrease its new business capital expenditures from $4.8 million in 2015 to the $3.2 million requested for 2017; while, at the same time, growing the company. GMG is constantly evaluating the requests for gas it receives from around the State of Minnesota and balancing them against its finances and ability to continue providing gas to unserved areas. GMG has not seen any reduction in the level of requests for new service. GMG anticipates that capital requirements will continue to be met with a combination of internal cash generation and new debt. However, GMG believes that the combination of its increasing customer base, decreased capital expenditures, and debt servicing on a 15 year

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> amortization schedule will contribute to an improved equity ratio over time....
>
> ...In the span of five years, GMG has reduced its capital expenditures by approximately 55% but has seen remarkable company growth over the same time period. Similarly, it has improved its EBITDA by $1.6 million and has increased the amount it paid on long-term debt principal by over $700,000 annually. *GMG believes that, if it is permitted to continue maintaining a similar equity ratio to that previously ordered by the Commission, the financial trends will continue and its financial health will steadily improve.* [emphasis added][6]

Based on this response, it is the Department's understanding that GMG believes that its current actions (increasing customer base, decreasing capital expenditures, and increasing debt principal payments) will result in an improved equity ratio over time, but for the foreseeable future, GMG would like to maintain its current equity ratio.

While the Department agrees that increasing customer base, decreasing capital expenditures, and increasing principal payments on debt *can* contribute to an improved equity ratio over time, none necessarily will. Moreover, they *will not* contribute to an improved equity ratio over time if GMG continues to issue as much debt as possible while maintaining the Commission's minimum-approved equity ratio, as the Company done for the last few years, and appears to want to do for the foreseeable future.

The decline in GMG's financial performance during 2015 and 2016, and the resulting need to inject equity to maintain the Commission's minimum-approved equity ratio, highlights the risk inherent in continually maintaining such a low equity ratio. GMG's high leverage leaves it with little capacity to endure a negative shock, such as another warm winter, an increase in interest rates, or any other type of unexpected expense. As the Department has pointed out in past capital structure Dockets, much of GMG's improved financial performance in 2013 and 2014 was attributable to lower interest rates resulting in lower average debt costs. If interest rates rise, much of that improvement will vanish. Additionally, a significant portion of GMG's long-term debt is comprised of bank loans with **[TRADE SECRET DATA HAS BEEN EXCISED].** A higher equity ratio and a smaller reliance on debt would help protect the Company.

In GMG's last few capital structure dockets, the intention behind the Department's recommendations has been to allow GMG some flexibility to pursue its expansion projects while maintaining a minimum degree of financial integrity. This strategy was based in part on the idea that aggressive expansion in the short- and medium-term would turn out to be

[6] See Department Attachment No. 2.

better for GMG's long-term financial health than a more conservative expansion plan that would improve GMG's equity ratio sooner rather than later. While the Department still wants GMG to be able to pursue system expansion, given GMG's performance in 2015 and 2016, the Department is now supportive of slightly stricter limits on that growth.

In Department Information Request No. 8, the Department asked GMG if it would be possible to revise its plans for 2017 in such a way that it would expect to achieve a 35 percent equity ratio by the end of the year, assuming normal weather.[7] In its response, GMG explained that

> Corporate planning is necessarily long term by its very nature; and, as such, cannot readily be changed on short notice without advising potential customers that GMG will not, in fact, be able to bring gas to them in 2017 despite its having earlier informed those customers that they met GMG's main extension rules.
>
> While that approach is theoretically possible, it would create significant financial uncertainty for GMG, would likely have severe long-term impacts and could ultimately mean that GMG cannot continue to make gas available to new areas in Minnesota. For example, some plans are designed to be contemporaneous with road projects and would likely be cost-prohibitive in the future. Additionally, GMG's credibility and the confidence of its customers would suffer, and that could result in future adverse financial ramifications.

The Department understands that GMG's capital structure petitions follow, and are designed to meet the needs of, its capital planning for the upcoming year. The Department therefore recommends that the Commission approve GMG's proposed 2017 capital structure with one minor modification, so that GMG does not have to alter its 2017 plans at this late date. However, the Department also recommends that the Commission impose requirements on GMG's next capital structure petition that are intended to result in a higher proposed equity ratio, as explained in greater detail below.

D. REASONABLENESS OF THE PROPOSED CONTINGENCY RANGES

1. Equity Ratio Range

As noted above, GMG has requested an equity ratio contingency range of 31.59 percent to 38.61 percent, which is identical to GMG's current approved range. For the reasons described above, the Department recommends that the Commission approve GMG's proposed equity ratio contingency range.

[7] See Department Attachment No. 3.

Additionally, the Department notes that the Commission often allows utilities to violate approved ranges for a period of 60 days without Commission notification. However, in recent years the Commission has not granted that extra flexibility to GMG with respect to its equity ratio, and required GMG to maintain an equity ratio at or above its approved floor at all times. Given GMG's current, low equity ratio and the risks inherent in the Company's expansion strategy, the Department recommends that the Commission impose this same restriction again in this Docket.

Additionally, in recent years the Commission required GMG to make monthly compliance filings demonstrating that GMG's equity ratio remained at or above the approved floor. The Department recommends that the Commission impose this same requirement on the Company again in this Docket.

2. Short-term Debt Ratio

In its Petition, GMG requested a short-term debt contingency cap of ten percent of its total capitalization. The Department considers this request to be reasonable, but emphasizes that GMG's equity ratio must remain at or above 31.59 percent at all times. Given GMG's current equity ratio of 31.90 percent,[8] the Company currently has little flexibility to issue short-term debt.

The Department recommends that the Commission allow GMG to violate the proposed short-term debt contingency cap of ten percent for up to 60 days, but not the proposed equity ratio floor.

3. Long-term Debt Ratio

In its Petition, GMG did not request a specific contingency range for its long-term debt ratio. Rather, the Company requested the flexibility to issue long-term debt provided that it remains within its equity and short-term debt contingency ranges and does not exceed them for more than 60 days. In other words, if GMG were to reduce its short-term debt ratio to zero, the maximum long-term debt ratio that would keep the Company within the proposed equity range would be 68.41 percent (equal to 100 percent minus 31.59 percent).

GMG's proposal is consistent with its past four capital structure Dockets, and the Department concludes that it is reasonable, with one minor clarification. The Department recommends that the Commission permit the company to issue long-term debt provided that it remains within its equity contingency range at all times, and remains within its short-term debt contingency range and does not exceed it for more than 60 days.

4. Total Capitalization

In its Petition, GMG requested Commission approval of a total capitalization of $39.6 million, with a contingency of $1.4 million, for a maximum capitalization of $41.0 million.

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[8] See GMG's Feb. 14, 2017 Compliance Filing in Docket No. G022/S-15-956.

The Department notes that the contingency amount of $1.2 million is equal to 3.2 percent of GMG's proposed capitalization, significantly less than the 10 percent capitalization contingency approved by the Commission in GMG's four most recent capital structure Dockets. The Department concludes that a 10 percent contingency is appropriate to protect the Company from unforeseen capital needs. The Department recommends a total capitalization of $39.6 million with a 10 percent contingency ($4.0 million) for a total of $43.6 million as shown in Table 6 below. The Department reiterates, however, that if GMG uses this total capitalization contingency, it must maintain an equity ratio of at least 31.59 percent.

Table 6
Department Alternative Contingency

	GMG Proposed Capital Structure December 31, 2017		Department Alternative Capital Structure December 31, 2017		
	Amount	Percent	Amount	Percent	Difference
Common Equity	13,047,669	32.94%	13,047,669	32.94%	-
Preferred Shares	-	0.00%	-	0.00%	-
Short-Term Debt					
Line of Credit	400,000		400,000		-
Current Portion of Long-Term Debt	1,030,800		1,030,800		-
Total Short-Term Debt	1,430,800	3.61%	1,430,800	3.61%	-
Long-Term Debt	25,130,551	63.45%	25,130,551	63.45%	-
Total Capitalization	39,609,020	100.00%	39,609,020	100.00%	-
Contingency	1,390,890	3.51%	3,960,902	10.00%	2,570,012
Total with Contingency	40,999,910	103.51%	43,569,922	110.00%	2,570,012

Source: Petition, Attachment 6, Part 1

E. RECOMMENDATIONS FOR 2018 CAPITAL STRUCTURE FILING

As noted above, the Department recommends that the Commission impose requirements on GMG's next capital structure petition intended to cause GMG to begin taking steps now to achieve a higher equity ratio by the end of 2018. Specifically, the Department recommends that the Commission require GMG:

- to file its next capital structure petition by January 1, 2018;
- to propose in its next capital structure petition a plan that would be expected to result in a 35.00 percent equity ratio by December 31, 2018, assuming normal weather, or explain why such an increase is not possible; and

- to propose in its next capital structure petition a step-increase in its equity ratio floor from 31.59 percent to 33.0 percent beginning October 31, 2018, or explain why such an increase is not possible.

Imposing these requirements now on GMG's next capital structure petition will allow the Company to plan appropriately over the next year to meet the modest, 1.41 percentage point increase in the minimum allowed equity ratio, as well as the slightly more aggressive, though still small, 3.10 percentage point increase in its expected equity ratio.

The Department understands that events may transpire between now and the time of GMG's next capital structure filing that make the increases impossible, and thus the Department's recommendations are intended to set expectations with respect to GMG's next filing, but still allow for some flexibility.

V. CONCLUSION AND RECOMMENDATIONS

GMG's financial performance in 2015 and 2016, which has resulted in the need for equity injections in order to keep the Company's equity ratio within the approved contingency range, highlights some of the risks associated with maintaining a low equity ratio for a sustained period of time. While the Department is not opposed to GMG's expansion plans which are driving its low equity ratio, the Department is concerned about the risks associated with maintaining such a low equity ratio indefinitely without any concrete plans to increase it. The Department also recognizes GMG's need for a long planning horizon and therefore the Department recommends that the Commission approve GMG's proposed 2017 capital structure, with one slight modification to the total capitalization contingency, and impose requirements on GMG's next capital structure intended to result in a higher equity ratio by the end of 2018.

The Department recommends that the Commission:

- approve GMG's proposed 2017 capital structure;
- approve an equity ratio contingency range of 31.59 percent to 38.61 percent;
- require that GMG maintain an equity ratio contingency range of at least 31.59 percent at all times;
- require GMG make monthly compliance filings on or before the 15th of each month containing a balance sheet, income statement, and cash flow statement for the first of the prior two months, demonstrating that its equity ratio is at least 31.59 percent;
- approve a short-term debt contingency cap of 10 percent (*i.e.,* GMG's short-term debt is not to exceed 10 percent of its total capitalization, including the contingency, for more than 60 days); and
- approve a total capitalization contingency of $4.0 million above the estimated 2017 year-end total capitalization of $39.6 million, for a total capitalization of $43.6 million.

- require GMG to file a new securities issuance and capital structure petition by January 1, 2018;
- require GMG to propose in its next capital structure petition a plan that would be expected to result in a 35.00 percent equity ratio by December 31, 2018, assuming normal weather, or explain why such an increase is not possible; and
- require GMG to propose in its next capital structure petition a step-increase in its equity ratio floor from 31.59 percent to 33.0 percent beginning October 31, 2018, or explain why such an increase is not possible.

/ja

2015 Capital Structures for Gas Utilities
With Bond Ratings from A- to BBB

Company	Stock Ticker Symbol	S&P Debt Rating	Short-Term Debt	Long-Term Debt	Common Equity	Total Capitalization	Equity Ratio
National Fuel Gas Co.	NFG	BBB	-	2,084.0	2,025.4	4,109.4	49.3%
ONE Gas, Inc.	OGS	A-	12.5	1,201.3	1,841.6	3,055.4	60.3%
South Jersey Industries, Inc.	SJI	BBB+	431.7	1,035.8	1,037.5	2,505.1	41.4%
Spire, Inc.	SR	A-	338.0	1,851.5	1,573.6	3,763.1	41.8%
Average							48.2%
Standard Deviation							7.6%

Source: Research Insight Database

State of Minnesota

DEPARTMENT OF COMMERCE
DIVISION OF ENERGY RESOURCES

Utility Information Request

Nonpublic [ ]
Public [X]

Docket Number: G022/S-16-931 Date of Request: January 12, 2017

Requested From: Kristine A. Anderson Response Due: January 23, 2017

Analyst Requesting Information: Craig Addonizio

Type of Inquiry:

[X]…..Financial	[ ]…..Rate of Return	[ ]…..Rate Design
[ ]…..Engineering	[ ]…..Forecasting	[ ]…..Conservation
[ ]…..Cost of Service	[ ]…..CIP	[ ]…..Other:

If you feel your responses are trade secret or privileged, please indicate this on your response.

Request No.	
7	Please generally describe GMG's long-term plans for capital expenditures, system expansion, and debt issuance. Does GMG anticipate either a decrease in capital expenditures in future years, or a decrease in the degree to which capital expenditures in future years will be financed with new debt (either of which will allow its equity ratio to increase)?

GMG RESPONSE:

GMG's capital budget is driven by system reliability and safety, government-sponsored and/or mandated road construction projects, and customer requests for service that meet the requirements of GMG's main extension rules. GMG has continued to steadily decrease its new business capital expenditures from $4.8 million in 2015 to the $3.2 million requested for 2017; while, at the same time, growing the company. GMG is constantly evaluating the requests for gas it receives from around the State of Minnesota and balancing them against its finances and ability to continue providing gas to unserved areas. GMG has not seen any reduction in the level of requests for new service. GMG anticipates that capital requirements will continue to be met with a combination of internal cash generation and new debt. However, GMG believes that the combination of its increasing customer base, decreased capital expenditures, and debt servicing on a 15 year amortization schedule will contribute to an improved equity ratio over time.

GMG respectfully submits that reflecting on its history over the last several years demonstrates its commitment to delivering natural gas to unserved areas while retaining and improving its financial stability. A comparison

Response by: Kristine Anderson

Title: Corporate Attorney

Department:

Telephone: 507-665-8657

List sources of information:

of its capital budgets and EBITDA over time demonstrates that while GMG has been able to consistently reduce its capital budget, it has simultaneously been able to increase its EBITDA and, therefore, its debt servicing capacity. Moreover, GMG has been able to accomplish that feat despite the winter of 2016 being one of the warmest on record and securing storage to benefit customers (which comes at the expense of shareholders). The table below summarizes GMG's financial progress:

Year	Capital Expenditures Budget	EBITDA	Principal Paid on Long-Term Debt
2013	$8.3 million	$2.3 million	$482,000
2014	$4.2 million	$2.6 million	$641,000
2015	$5.3 million	$2.6 million	$811,000
2016 preliminary	$3.95 million	$3.3 million	$1.078 million
2017 projected	$3.7 million	$3.9 million	$1.216 million

In the span of five years, GMG has reduced its capital expenditures by approximately 55% but has seen remarkable company growth over the same time period. Similarly, it has improved its EBITDA by $1.6 million and has increased the amount it paid on long-term debt principal by over $700,000 annually. GMG believes that, if it is permitted to continue maintaining a similar equity ratio to that previously ordered by the Commission, the financial trends will continue and its financial health will steadily improve.

Response by: Kristine Anderson

Title: Corporate Attorney

Department:

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List sources of information:

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DEPARTMENT OF COMMERCE
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Nonpublic [ ]
Public [X]

Utility Information Request

Docket Number: G022/S-16-931 Date of Request: January 12, 2017

Requested From: Kristine A. Anderson Response Due: January 23, 2017

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Type of Inquiry:			
	[X] Financial	[ ] Rate of Return	[ ] Rate Design
	[ ] Engineering	[ ] Forecasting	[ ] Conservation
	[ ] Cost of Service	[ ] CIP	[ ] Other:

If you feel your responses are trade secret or privileged, please indicate this on your response.

Request No.	
8	Please explain whether it would be possible for GMG to revise its 2017 debt-issuance plans in such a way that it would expect to achieve a 35.00 percent equity ratio by the end of 2017 (assuming normal weather).

GMG RESPONSE:

GMG's plans are predicated on meeting the equity ratio previously ordered by the Commission. GMG has maintained that ratio despite extending service to new areas, bringing natural gas to approximately 2,000 new residents since 2013, and securing storage (which inures to the customers' benefit) without recovering any carrying charge. Throughout the last several years, GMG's cash flow and ability to service its debt have been increasing, all while maintaining the required equity ratio. Corporate planning is necessarily long term by its very nature; and, as such, cannot readily be changed on short notice without advising potential customers that GMG will not, in fact, be able to bring gas to them in 2017 despite its having earlier informed those customers that they met GMG's main extension rules.

While that approach is theoretically possible, it would create significant financial uncertainty for GMG, would likely have severe long-term impacts and could ultimately mean that GMG cannot continue to make gas available to new areas in Minnesota. For example, some plans are designed to be contemporaneous with road projects and would likely be cost-prohibitive in the future. Additionally, GMG's credibility and the confidence of its customers would suffer, and that could result in future adverse financial ramifications.

Response by: Kristine Anderson

List sources of information:

Title: Corporate Attorney

Department:

Telephone: 507-665-8657

GMG acknowledges that if it eliminates or substantially reduces main extensions and new debt issuance in 2017, its equity ratio will temporarily increase; but, the short-term benefits will ultimately have an adverse impact on ratepayers. Gas utilities operate in a rising cost environment. For example, GMG's property taxes have more than doubled over the 2013 to 2016 period and continue to rise dramatically, which is reflected in the table below.

Year	Property Taxes
2013	$281,000
2014	$353,000
2015	$535,000
2016 preliminary	$626,000
2017 projected	$800,000

As discussed in GMG's Response to Information Request No. 7, the Company has been able to increase EBITDA, reduce net new debt issuance, and hold rates constant for ratepayers by using growth to offset rising cost. GMG's successful business model has allowed it to balance serving people who have been denied access to essential services for year, investing in safety and reliability, improving its financial situation, and controlling costs for those things by spreading costs over a larger customer base, thus minimizing the impact to ratepayers.

GMG has provided a plan that provides an essential service to previously unserved parts of Minnesota, maintains rate stability for customers, and continues to improve GMG's financial capabilities on a sustainable path. GMG respectfully requests the Department recommend and the Commission approve the plan as proposed by the Company.

Response by: Kristine Anderson

Title: Corporate Attorney

Department:

Telephone: 507-665-8657

List sources of information:

CERTIFICATE OF SERVICE

I, Sharon Ferguson, hereby certify that I have this day, served copies of the following document on the attached list of persons by electronic filing, certified mail, e-mail, or by depositing a true and correct copy thereof properly enveloped with postage paid in the United States Mail at St. Paul, Minnesota.

Minnesota Department of Commerce
Public Comments

Docket No. **G022/S-16-931**

Dated this 16th day of February 2017

/s/Sharon Ferguson

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